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April 7, 1998



HAND DELIVERY

Magalie Roman Salas
Secretary
Federal Communications Commission
1919 M Street, N.W., Room 222
Washington, D.C. 20554

Re: Ex Parte Presentations
CC Dkt. No. 96-45 (Report to Congress)

Dear Ms. Salas:

This letter is to notify you that Barbara Dooley, of the Commercial Internet eXchange Association ("CIX"), Ronald Plesser, James Halpert, and I met yesterday with John Nakahata, Chief of Staff of Chairman Kennard's office. Mr. Plesser and I also met yesterday with James Casserly, Senior Legal Advisor to Commissioner Ness. During the meeting, we discussed CIX's position on USF issues and the Commission's upcoming Report to Congress. Consistent with its prior presentations on USF filed in the above-captioned docket, CIX believes that the Commission correctly found that Internet Service Providers are not obligated to pay directly into the USF contribution mechanism. As end-user purchasers of telecommunications, however, Internet service providers ultimately bear the costs of USF programs. The attached letter, filed with the Commission on April 3, 1998, was presented to Mr. Nakahata and Mr. Casserly.

In the meetings, CIX also expressed its concern with proposals to include Internet "self-provisioning" within the realm of the direct USF contribution base. In CIX's view, such regulation would invite additional regulation of the Internet, which is contrary to the Commission's policy objectives. Also, the "self-provisioning" issue seems, at this point, to be only a theoretical concern that should not drive a shift in Internet policy.

An original and two copies of this letter is transmitted herewith for inclusion in the above-referenced dockets. Should you have any questions concerning this matter, please feel free to contact the undersigned.

Sincerely,

Mark J. O'Connor

cc: John Nakahata
James Casserly

STAMP IN


April 3, 1998



Chairman William E. Kennard
Federal Communications Commission
1919 M Street, N.W., Room 814
Washington, D.C. 20554

Robert M. Pepper
Chief of Office of Plans and Policy
Federal Communications Commission
1919 M Street, N.W., Room 822
Washington, D.C. 20554

Re: Ex Parte Presentation
CC Docket No 96-45 (Report to Congress)

Dear Chairman Kennard and Dr. Pepper:

The Commercial Internet eXchange Association ("CIX") writes to provide the Commission with additional information for its report to Congress concerning universal service issues. In its comments, CIX set forth responses addressing the questions posed by Congress. In this submission, which is supported by the Coalition of Utah Independent Internet Service Providers (CUISP), the Internet Service Providers Consortium (ISP/C), the Mississippi Internet Service Providers Association (MISPA), and the Western Regional Networks (rural western Utah and Colorado) [Attachment B], we wish to provide additional factual information concerning Internet service providers' (ISPs') payments to support the PSTN.

CIX supports the goals of universal service to keep the cost of telephone service affordable for residential and rural customers. We are strongly opposed, however, to efforts to regulate Internet Service Providers as telecommunications providers in order to subsidize this program.

Far from receiving "subsidized" telecommunications service, as some commentators have suggested in this proceeding, ISPs pay significant percentages of their annual revenues to telecommunications providers. Some of these payments -- multi-line business SLC and PICC charges -- are paid directly as access charges, and were increased by the Commission's access charge order. Other payments, such as those for T1 lines and

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other private lines are paid to carriers, whom we believe pass along federal and state universal service charges to ISPs.

Although no one knows the number of ISPs in the United States, the growth in this industry has been explosive to the great benefit of our economy. In a 1997 survey, CIX established that almost 66% of ISPs in the US were small businesses which had been in business less than three years with less than $1 million in revenues. *Boardwatch* Magazine currently estimates there are over 4000 US ISPs, a 20% increase over 1997; in fact, the number of companies and the growth rate is likely to be considerably higher. Most of this increase can be linked to the establishment of new small businesses in the past two years. Many of these providers are providing service to residential and rural customers—consumers and small businesses—not served by the large national online and Internet service providers.

In Attachment A, we report March 1998 findings from ten Internet service providers which corroborate our March 1997 survey results and give additional details regarding the impact of telecommunication costs on their businesses. Most of the sample (7 companies) are small businesses, two are medium-sized companies, and one is a division of a large multinational company. Most of the companies are either not profitable or only marginally so. Telecommunications costs represent by far the largest percent of both cost of sales and revenues in almost every case. These companies are spending 30-50% or more of revenues on telecommunications costs, and these costs represent 30-50% or more of cost of sales.

These companies buy both business and T-1 and private lines, the mix of which depends on their customer base. The impact of the new SLC and PICC charges, in addition to what is paid on their behalf into universal service by carriers is substantial. With small or non-existent margins today, increased telecommunications costs and business growth requiring more circuits (most ISPs are growing at 5-10% or more *per month*), the portion of operating budget devoted to telecommunications will have a noticeable impact on many companies' ability to stay in business or remain competitive. For ISP businesses to grow and become profitable, they must be able to invest in other areas of their businesses besides telecommunications services.

Even though ISPs indirectly pay into the universal service fund, it remains to be seen whether any have received any benefits from it. One state association of ISPs reports, for example, that not a single member of the association is participating in the USF program to subsidize Internet access for schools and libraries, though they would like to be able to compete for this business.

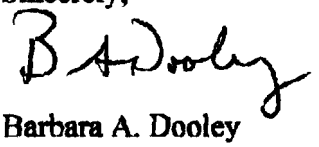
Furthermore, Internet service providers operate in a highly competitive, very low margin business which provides little room to pass along universal service charges or access charges to customers. For this reason, CIX is convinced that imposing increased charges on ISPs would hasten the consolidation of this highly competitive, dynamic industry, significantly reducing the choices available to consumers today.

Exposing ISPs to state and foreign nation regulation by declaring parts of their services to be "telecommunications" would do further damage to the industry, significantly raising the ISPs' regulatory costs and exposing them to being excluded from markets on the ground that they were providing unlicensed telecommunications service.

We strongly urge the FCC to continue to reduce regulation in the implementation of the Telecommunications Act of 1996 and to affirm its decision that Internet Service Providers are not obligated to make direct contributions to the Universal Service Fund.

In accordance with the Commission's *ex parte* rules, two copies of this letter will be submitted to the Commission's Secretary.

Sincerely,



Barbara A. Dooley
Executive Director

# ATTACHMENT A

Case 1
A small central Midwestern ISP serving rural and urban customers in two states which has been in business three years. This company has annual revenues of less than $500,000 and telecommunications costs in 1997 represented more than 30% of revenues. Telecommunications costs represented almost 36% of cost of sales in 1997. This company is experiencing 6% increase in its telco orders monthly, almost 75% increase for 1998. The company was profitable in 1997 "because of low salaries."

Case 2
A small provider in Arizona serving both rural and urban customers which has been in business three years. This company's revenues were approximately $650,000 in 1997 and telecommunications costs represented more than 42% of subscriber revenues. It spent 34% of its operating budget on telco in 1997. The company is seeing a phenomenal increase in provisioning expenses, expanding at greater than 200 percent per month. It ran a substantial deficit in 1997.

Case 3:
A small ISP serving urban and rural customers three Northeastern states says it has been in business almost 3 years and it reports "marginal" profitability. The company's revenues approached $400,000 and it paid out 30% of that number in telecommunications costs. The company's telecommunications bill represented 40% of the cost of sales in 1997. This ISP projects a 15% monthly increase in telecommunications circuit provisioning.

Case 4
A small provider in the Southeast ( which has done business in several forms since 1993) experienced a cost of communications almost as high as its subscriber revenues and therefore suffered a major loss in 1997. The company's subscriber revenue totaled $360,000 in 1997 and telecommunications costs alone came to 87.5% of subscriber revenues. The provider is expecting to expand its telecommunications provisioning at the rate of 10% per month this year.

Case 5
A small service provider covers urban and rural customers in two north central Midwestern states for the past two years and says it was "barely" profitable in 1997. The company's subscriber revenues came to approximately $400,000 and its telecommunications expenses came to 35% of that. .This company reported telecommunications costs of 40% of the cost of sales. It expects to increase circuit provisioning 10% per month in 1998. The service provider reports that the SLC and PICC charges on its telecommunications bills this year amount to a total telecommunications cost increase of 10%.

Case 6
A small provider in the Mountain region has been in business 4 years and showed a profit in 1997. The company reported revenues of approximately $1 million. Telecommunications costs which represented 34% of those revenues. This company is looking at a 5% monthly increase in telecommunications provisioning in 1998 and says that the new SLC and PICC charges by themselves will affect a 26% increase in telecommunications this year.

Case 7

A small provider in the Southeast says that it did record a profit in 1997 starting out with 1997 subscriber revenues of just over $ 2 million. This company has been in business for 4 years and serves a cross section of urban and rural subscribers. It saw telecommunications as representing 55% of the cost of sales. The company says its plans for 1998 includes a 5% monthly growth in telecommunications provisioning.

Case 8

A large national provider providing backbone services to businesses and ISPs in businss more than five years but not yet profitable. It reported that telecommunications came to 54% of its cost of sales. This company expects to grow its telecommunications circuit provisioning by almost 100% percent this year. The company estimates that since January 1998 there has been a 3% increase in telco costs as a result of SLC increases, but is unable to estimate the impact of PICC charges on its telco costs. It anticipates that these increases will have a small total impact on its total cost of sales in 1998.

Case 9

A growing national provider concentrating on dialup and business customers in the majority of states. They are an established company, in business more than five years, but not yet profitable. In 1997, telecommunications costs represented 30% of revenue. Telco services represented more than 40% of cost of sales in 1997. This company notes that its telco costs are rapidly increasing in 1998 for a number of reasons: 1) their RBOC vendors often will only sell high-cost trunk-side services to them; 2) they are seeing a monthly increase since January 1998 of more than $200,000 because of SLC/PICC and USF costs with an estimated impact on their telecommunications costs in 1998 over more than $2.5 million. These increases are already noticeable in the company's inability to rapidly add QoS and other value-added services which are critically necessary for them to remain competitive in the industry.

Case 10

A large national provider servicing dialup and business customers in the majority of states. Telecommunications services represented more than 22% of its total 1997 costs; their 1998 budget estimated telco costs again at 22% but the estimated impact of increases in SLC/PICC and contributions will cause a significant overall increase in telecommunications costs of more than 5% of almost $4 million this year.

## ATTACHMENT B

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**INTERNET SERVICE PROVIDERS' CONSORTIUM**
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November 1997

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April 3, 1998

HAND DELIVER

Magalie Roman Salas
Secretary
Federal Communications Commission
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Washington, D.C. 20554

Re: Commercial Internet eXchange Association
CC Dkt. No. 96-45 (Report to Congress)
*Ex Parte* Presentation

Dear Mr. Caton:

In conformity with the Commission's rules, enclosed please find two copies of a written *ex parte* presentation for inclusion in the above-referenced docket. Originals of the attached letter were hand-delivered this day to Chairman Kennard and Mr. Pepper.

Should you have any questions concerning this matter, please contact the undersigned directly.

Sincerely,

Mark J. O'Connor
Counsel for the Commercial Internet
eXchange Association

/mjo
Enclosures